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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1951

No. 231

UNITED STATES,
Petitioner,
vs.
DON GILMORE and SUE GILMORE,
Respondents.

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR RESPONDENT DON GILMORE

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Subject Index

	Page
Questions presented	1
Statutes and regulations involved	2
Statement	2
Summary of argument	4
Argument	7
The Court of Claims was correct on the basis of its findings of fact in determining that eighty per cent of the legal expenses paid by Don Gilmore were deductible as expenses for services rendered for the conservation and maintenance of property held for the production of income	7
Must there be a profit-seeking activity of a business type for the application of Section 23(a)(2) and Section 212(2)?	11
The legal expenses incurred by Don Gilmore were incurred in and about a community property relationship	12
Is the origin of the dispute controlling?	15
Were the legal expenses paid to defend against a liability?	17
Whether the legal expenses found to be deductible by the court below should in part be held to be capital expenditures in defense of title to property	18
Conclusion	24

Table of Authorities Cited

Cases

	Pages
Baer v. Commissioner (8 Cir., 1952) 196 F. 2d 646	16, 22
Bingham's Trust v. Commissioner of Internal Revenue, 325 U.S. 365, 65 S. Ct. 1232	11, 12, 16
Bowers v. Commissioner (6 Cir., 1957) 243 F. 2d 904	16
Estate of Arstein (1961) (Calif.) 56 A.C. 229, 364 P. 2d 33	20
Estate of Frederick Cecil Bartholomew, 4 T.C. 349	21
Estin v. Estin (1948) 334 U.S. 541, 68 S. Ct. 1213	14
Falls v. Commissioner (1946) 7 T.C. 66	20

Pages

Green v. Green (1944) 60 Cal. App 2d 50, 151 P. 2d 679 14

Harris v. U.S. (9 Cir.) 275 F. 2d 238 ..... 21, 22
Hochschild v. Commissioner (2 Cir.) 161 F. 2d 817 23
Howard v. Commissioner, 202 F. 2d 28 15

Lewis v. Commissioner (2 Cir.) 253 F. 2d 821 ..... 11, 15, 16, 17
Lykes v. U.S., 343 U.S. 118 17

McMurtry v. U.S. (Ct. Cl. 1955) 132 F. Supp. 114 17

Niles Bement Pond Co. v. U.S., 281 U.S. 357, 50 S. Ct. 254 7

Owens v. Commissioner, 273 F. 2d 251 (5 Cir.) 7, 16

Patrick v. U.S. (4 Cir., 1961) 288 F. 2d 292 16
Pereira v. Pereira, 156 Cal. 1, 103 P. 488 20

Rassenfoss v. Commissioner (7 Cir.) (1946) 158 F. 2d 764 23

Sergievsky v. McNamara (1955) 135 Fed. Supp. 233 23
Shipp v. Commissioner of Internal Revenue (9 Cir.) 217 F. 2d 401) 22, 23

U.S. v. Esnault-Pelterie, 58 S. Ct. 412, 303 U.S. 26 7

Vanderbilt v. Vanderbilt (1957) 354 U.S. 416, 77 S. Ct. 1360 14

Codes

California Civil Code:
Section 158 13
Section 172a 21

Internal Revenue Code of 1939:
Section 22(k) 16
Section 23(a)(2) ..... passim
Section 24 19
Section 24(a)(1) 5, 15

Internal Revenue Code of 1954:
Section 71 16
Section 212(2) 2, 4, 6
Section 262 ..... 5, 15
Section 263 19

Treasury Regulations

1954 Code: Page
Section 1.212-1, subdivision (b) 21
Section 1.263(a)-2, subdivision (e) 19
Section 39.23(a)-15, subdivision (b) 21
Sections 39.24(a)-1 and 1.262-1(b)(7) 16
Section 39.24(a)-2, subdivision (a) 19

Texts

10 Cal. Jur. 2d 665 13
1 de Funiak, Principles of Community Property:
Page 3 13
Pages 7 and 8 12
Page 8 13
34 Op. Atty. Gen. 395 13
4 Witkin, Summary of California Law, 7th Ed., 2705 13

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1961

No. 255

UNITED STATES,
Petitioner,
vs.
DON GILMORE and SUE GILMORE,
Respondents.

On Writ of Certiorari to the United States Court of Claims

BRIEF FOR RESPONDENT DON GILMORE

QUESTIONS PRESENTED

1. Whether amounts paid for legal services by a husband (Don Gilmore) to defeat his wife's (Dixie Gilmore's) claims made in a divorce action, to one-half of the increase in value of his shares of stock in three corporations controlled by him, are deductible, for income tax purposes, as "ordinary and necessary expenses paid * * * for the * * * conservation, or main-

tenance of property held for the production of income", as provided by Section 23 (a)(2) of the Internal Revenue Code of 1939 and Section 212 (2) of the Internal Revenue Code of 1954.[1]

2. A subsidiary question is whether the legal expenses found to be deductible by the court below should in part be held to be capital expenditures in defense of title to property.

STATUTES AND REGULATIONS INVOLVED

Appellee supplements in the Appendix, infra pp. i-iii, additional provisions of statutes and regulations not included in the Appendix of Petitioner.

STATEMENT

Appellee adds to the "Statement" of Petitioner the following facts found to be true by the court below.

Dixie Gilmore claimed that the increase in value of Don Gilmore's stock was community property under California law because the increase consisted of money earned by virtue of the personal services of Don Gilmore to the corporations. (R. 130, F. 19.)[2] Don Gilmore was advised by his attorneys that any increase in the value of his stock as the result of his personal efforts or services during his marriage was recognized

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[1]Sue Gilmore married Don Gilmore in 1945; the issues before this court involve 1953 and 1954 only. (R. 125, 142.)

[2]The letter "F" used herein denotes the Findings of Fact of the Court of Claims.

by California law as community property. (R. 131, F. 20(e).)

The court below found that: "The evidence, particularly the facts set forth in finding 23, establishes that 80 percent or more of the amounts which Don Gilmore paid to his attorneys and his accountant in 1953 and to his attorneys in 1954 were for services rendered by them to defeat Dixie Gilmore's claims to one-half of the value of the increase of his stock in the three dealership corporations, and to establish that no portion of such stock was community property." (R. 137, F. 30.)

In 1952 and 1953 Don Gilmore was sixty-two years of age and he was too old to get another job as president and general manager of an automobile dealership, except through a controlling stock ownership interest. (R. 129, F. 14.) He received the following salaries from such employment:

1949	$79,800.00
1950	61,316.65
1951	66,799.92
1952	66,799.92

(R. 128, F. 9.)

Don Gilmore was paid such salaries only because of his controlling stock ownership interest in the corporations employing him. His compensation for corresponding positions would have to be greatly reduced if he were employed by corporations which he did not own outright or control. (R. 129, F. 13.)

If Don Gilmore's wife succeeded in obtaining the community interest (increase in value of his stock)

and the dealership contracts of the corporations were canceled as a result thereof. Don Gilmore would have lost his positions and his salaries, and he was too old at the time to get similar positions with other automobile dealers. (R. 136, 137, E. 29.)

SUMMARY OF ARGUMENT

The court below found it to be a fact that 80 percent or more of the amounts which Don Gilmore paid for legal expenses were for services to establish that no part of his stock in the three dealership corporations consisted of community property and to defeat his wife's claims to one-half of the increase in value of such stock. It is unquestioned that this finding is supported by the record. In so finding the court below also determined as a fact that the remaining 20 percent of the legal expenses was personal, that is, for services in respect to the issues of divorce (including alimony) and the two residences.

Admittedly, the stock owned by Don Gilmore in the three corporations consisted of property which he held for the production of income. Thus 80 percent of the legal expenses were found as a fact by the court below to be for the conservation of property held for the production of income. Therefore Section 23 (a) (2) of the 1939 Code and Section 212(2) of the 1954 Code are definitely applicable to 80% of the legal expenses.

The court below found that the dominant and primary purpose of the services of the attorneys and the

accountant was to conserve such property held for the production of income. It follows that the remaining 20 percent was for services of a personal nature which came within Section 24 (a) (1) of the 1939 Code and Section 262 of the 1954 Code.

Although Don Gilmore and Dixie Gilmore were married they also had a community property relationship of a quasi business character. The community property system in California creates sort of a partnership between husband and wife. All earnings of the spouses from their services are owned equally by them as community property. They share community income, gains and losses equally. Claims which they may make against each other in respect to such community property relate to their rights and duties in respect to such property relationship. A husband and wife in California may make contracts with respect to property and may deal with each other in regard thereto just as unmarried persons.

Although the stock in the three corporations was of paramount importance to Don Gilmore, there was also of supreme importance to him the positions that he had in the three corporations from which he realized substantial compensation. The maintenance of his employment and his compensation from his employment were conditional on his continued ownership of the controlling stock interests in the three corporations. Therefore, to maintain his employment, it was necessary for him to keep control of the three corporations through his stock ownership. It follows that the expenditures which he made were vitally related

to the conservation of his positions in the three corporations.

To deny the deduction of the expenses which the court below held to be for the conservation of property held for the production of income would be to disregard the findings of fact of the court below and the words of the statute (Section 23 (a)(2) and Section 212 (2)) and would defeat the obvious purpose of the statute.

None of the legal expenses in issue should be treated as capital expenditures because they were not paid to defend or perfect title to income-producing property. Don Gilmore had complete title to the stock in the corporations before marriage and he had the same title after marriage. His wife did not claim that he did not have title. In fact, her rights, if any, depended on his having title. His title to the stock was clear and marketable. The defense against Dixie Gilmore's claims was not calculated to enhance the value of the stock. The claim made by Dixie Gilmore to the increase in value of the stock was a claim to accumulated community income which was alleged to be reflected in the increase in value of the stock. Even though the increment or appreciation in value alleged to be due to accumulated community income was unrealized, nevertheless, her claim was to 50 percent of a gain in value. From this viewpoint it would seem that the legal expenses in issue were paid by Don Gilmore to protect his right to the unrealized gain in the value of his stock. It would thus follow that contrary to regarding the legal expenses as capital

expenditures, an alternative ground is presented for duction by Don Gilmore of the legal expenses under Section 23 (a)(2), viz., as expenses proximately related to the production or collection of income.

ARGUMENT

THE COURT OF CLAIMS WAS CORRECT ON THE BASIS OF ITS FINDINGS OF FACT IN DETERMINING THAT EIGHTY PERCENT OF THE LEGAL EXPENSES PAID BY DON GILMORE WERE DEDUCTIBLE AS EXPENSES FOR SERVICES RENDERED FOR THE CONSERVATION AND MAINTENANCE OF PROPERTY HELD FOR THE PRODUCTION OF INCOME.

The record clearly shows that Dixie wanted a substantial part of the income-producing property of Don Gilmore; that is what the fighting was about. The court below determined as an ultimate fact that Don Gilmore paid 80% of the legal expenses to protect his income-producing property. That findings of fact of the Court of Claims are conclusive, see *U.S. v. Esmault-Pelteria*, 58 S. Ct. 412, 414, 303 U.S. 26, 29; *Niles-Bement Pond Co. v. U.S.*, 281 U.S. 357, 360, 50 S. Ct. 251, 252. He also made some expenditures for legal services which more directly related to his marital rights and obligations. In effect the court below determined that the issue relating to the community property rights was divisible and severable from the issues of divorce and alimony. In the words of the court in *Orcutt v. Commissioner*, 273 F. 2d 251 (5 Cir.), the "domestic dispute furnished the occasion, but not the motive, for the payment of the $7,500 to the attorney."

The testimony of Wallace Myers, chief trial attorney for Don Gilmore in the Superior Court of California, shows that neither party was interested in defeating each other's claim for divorce to save the marriage (see F. 17, R. 129); and it also illustrates the relative unimportance of the divorce and alimony issues compared with the main issue of the claim made by Dixie to community property alleged to be reflected in the increase in value of Don Gilmore's stock. On cross-examination by Mr. Pester, government counsel, Wallace Myers testified as follows (R. 88, 89 and 90):

"Mr. Pester. Q. You were engaged in the trial of this case for about 21 days?

A. 24 trial days.

Q. 24 trial days?

* * * * * * *

Mr. Pester. Q. Let's eliminate from this Gilman divorce action the community property issue. Upon the trial of the case, on all the other issues involved, what would you consider a reasonable attorney's fee?

A. Well, in the first place, the case wouldn't have lasted two days, and I would have probably charged him about $1,000.

Q. You mean it wouldn't last two days with all this conduct issue in it?

A. We would have never gone into it. She could have walked into Court and had a divorce and gotten alimony for a reasonable time, and there would never have been a fight. We were not fighting about alimony.

Q. Well, you were fighting the divorce, and the conduct of Mr. Gilmore——

A. We only had to fight it because she was asking for something like $300,000 in money that didn't belong to her, and she was trying to taint that with community property.

Q. Isn't it a fact that you also fought on the conduct issue?

A. Certainly we fought on the conduct issue.

Q. Wouldn't that have taken more than a day or two days?

A. Well, may I put it this way, Mr. Pester: If you are fighting over $1,000, you don't try a 24-day case. I don't. That case wouldn't have lasted two days, because we would have never really pressed it.

Q. But the $1,000 wasn't involved in the conduct issue, was it?

A. The conduct issue was only involved because there was $600,000 or thereabouts of property involved. That is the only reason."

It becomes clear from a consideration of the findings of ultimate fact by the court below and from the record supporting the findings that the primary and dominant issue was not the divorce or alimony but protection of income-producing property and Doy Gilmore's salaries from the corporations, both being his source of income. It is in this light that the language in the opinion of the court below (R. 119), quoted in Petitioner's Brief[3] at page 7, becomes meaningful. To repeat, the court stated that:

"* * * in every divorce case a certain amount of legal expenses are incurred for the purpose of

[3]Hereafter reference to Petitioner's Brief will be by the letters "P.B."

> obtaining the divorce and a certain amount are incurred in an effort to conserve the estate and are not necessarily deductible under section 23 (a)(2), but when the facts of a particular case clearly indicate that the property, around which the controversy evolves, is held for the production of income and without this property the litigant might be denied not only the property itself but the means of earning a livelihood, then it must come under the provisions of section 23(a)(2) * * *."

By such statement the court means that when the evidence shows that expenditures for legal services are made primarily to conserve income-producing property, the fact that such expenditures are made for services in a divorce proceeding does not change the primary purpose of the expenditures.

Contrary to the assertion made in Petitioner's Brief (P.B. 17), the court below did not allocate the legal expenses in question to the "property-settlement aspect of a divorce proceeding". In *Gilmore* there was an early attempt at property settlement which was abandoned before trial. (R. 130, 131.) The fight on the question of community property took place in court. The issue was litigated, not settled. The legal expenditures were not made to resist financial demands for alimony or any liability. Legal services were not rendered to rearrange or adjust property rights between the spouses. Dixie Gilmore made a direct attack against Don Gilmore's stock. She used every means at her command. Don Gilmore's legal expenditures in question related only to the defense and protection of his stock and what it entailed.

MUST THERE BE A PROFIT-SEEKING ACTIVITY OF A BUSINESS TYPE FOR THE APPLICATION OF SECTION 23(a)(2) AND SECTION 212(2)?

Petitioner asserts (P.B. 22), despite the plain language of Section 23(a)(2) and Section 212(2) which permits deduction of ordinary and necessary expenses incurred "for the management, conservation, or maintenance of property held for the production of income", that deductibility should be limited to "business"-type expenses. Appellee submits that the court in *Lewis v. Commissioner* (2 Cir.) 253 F. 2d 821, 825, which used the term "profit-seeking activity" did not necessarily mean that the "profit-seeking activity" to which the expense should relate must be an expense of a "business" type. It should be observed that the statutory language of Section 23(a)(2) and Section 212(2) requires that the expenses relate to "property held for the production of income". Whether the holding of property for the production of income is an activity in the business sense seems beside the point. In *Bingham's Trust v. Commissioner of Internal Revenue*, 325 U.S. 365, 65 S. Ct. 1232, 1237, the court stated that Section 23(a)(2) is comparable and *in pari materia* with Section 23(a)(1) authorizing the deduction of business or trade expenses and that "the effect of Section 23(a)(2) was to provide for a class of nonbusiness deductions coextensive with the business deductions allowed by § 23(a)(1), except for the fact that since they were not incurred in connection with a business, the section made it necessary that they be incurred for the production of income or the management or conservation of property held for the pro-

duction of income". It will be observed that the court in *Bingham's Trust* makes reference to the introductory title of Section 23(a)(2) which characterizes the expenses as "non-trade or non-business" expenses. Is it not reasonable to interpret this language to mean that the type of expenses involved are "non-business" type expenses rather than "business" type expenses? Whether the activity is characterized as profit-seeking or income-seeking would seem to be immaterial insofar as the proper meaning of Section 23(a)(2) is concerned. The use of the term "profit-seeking" should not lead to the conclusion that what is intended by the statute is necessarily a business-kind of expense.

THE LEGAL EXPENSES INCURRED BY DON GILMORE WERE INCURRED IN AND ABOUT A COMMUNITY PROPERTY RELATIONSHIP.

Because the legal concept of the community property system is so foreign to that of the common law, it is frequently very difficult for the legal mind trained and versed in the common law to grasp and understand its principles. It is a mistake to understand it and interpret it by the principles and terminology of the common law. 1 de Funiak Principles of Community Property, pp. 7 and 8. Chief Justice Stone of the United States Supreme Court said, while Attorney General of the United States, that the confusion in the decisions of the California courts with respect to community property undoubtedly arose "from the fact that the courts have been attempting in their opinions to apply the terminology of the com-

mon law to community property which embodies a legal concept wholly foreign to the common law and to which the terminology of the common law cannot be applied with accuracy and precision." 34 Op. Atty. Gen. 395. It is said: "Generally, the relationship between the spouses with respect to community property is regarded as being in the nature of a partnership." 10 Cal. Jur. 2d 665. Again: "The general theory is that the husband and wife form a sort of partnership, and that property acquired during the marriage by the labor or skill of either belongs to both." 4 Witkin Summary of California Law 7th Ed., 2705. And "* * * during the existence of the marital relationship the spouses are the joint owners, or partners, with respect to gains and losses." 1 de Funiak Principles of Community Property 3. Also, either husband or wife may enter into an engagement or transaction with the other respecting property which either might do if unmarried. California Civil Code § 158.

The quasi-business relationship between the husband and wife based on the community property system in California is discussed by de Funiak, supra, at page 8. In commenting on the general misunderstanding of the law of community property, he states:

> "It may sometimes arise because of the mistaken belief that the community property system substitutes some sort of a cold blooded partnership for marriage as a sacrament, that it substitutes a business relationship for what they consider a sacred relation between husband and wife."

In a footnote (20) on page 9, the following comment is made:

> "Actually the marital partnership in the common earnings and gains is not a substitute for but something in addition to marriage as a sacrament (or status or whatever one views it as being). The marital partnership in the earnings and gains may be dissolved by agreement during the marriage without in any way affecting the subsistence of the marriage itself. * * * '* * * matrimony is only the occasion for the partnership which the spouses have in the profits and the cause of this partnership is the law which establishes it'."

Whether the community property relationship is characterized as a quasi-business relationship, a partnership, a profit-seeking activity, or an income-seeking activity, a dispute between spouses over community property provides a separate issue independent of the issue of divorce. As to divisibility of the issue of divorce from other issues between husband and wife, see *Estin v. Estin* (1948) 334 U.S. 541, 68 S. Ct. 1213; *Vanderbilt v. Vanderbilt* (1957) 354 U.S. 416, 77 S. Ct. 1360. It is established that the spouses may or may not dispose of their community property relationship in a divorce action. In a divorce case where it is not determined whether there is community property, or in which there is no disposition of the community property, the rights of the spouses continue to remain and they may be litigated in a separate independent action. (*Green v. Green* (1944) 60 Cal. App. 2d 50, 51, 151 P. 2d 679.)

A proper understanding of the community property system in California would therefore seem to meet the "profit-seeking activity" test of the deductibility

of legal expenses advanced by petitioner. In this light the legal expenses were paid for services in and about a quasi-business community property controversy. It has not been suggested that the expenses were not ordinary and necessary.

IS THE ORIGIN OF THE DISPUTE CONTROLLING?

Petitioner's contention that the legal expenses in issue had their origin in marital discord and therefore are personal under Section 24(a)(1) of the 1939 Code and Section 262 of the 1954 Code, is unsound because whatever the personal discord of the spouses may have been, the merits of their controversy over income-producing property was not materially affected by their personal differences. This is brought out by the court in *Lewis v. Commissioner of Internal Revenue,* 253 F. 2d 821, in commenting on *Howard v. Commissioner,* 202 F. 2d 28, which involved the deductibility of the expenses of an army officer in defending himself before a court martial. The court said at page 825,

> "The charges against him, though they had their origin in a marital dispute, were directed to his status as a commissioned officer * * *. The very issue before the tribunal was whether Howard should lose that status and its income concomitants."

That a dispute about property between a husband and wife may have its origin in a divorce and nevertheless be divisible and severable is clearly illustrated

by Treasury Regulations 118, Section 39.24(a)-1 and Section 1.262-1(b)(7) of the Treasury Regulations on Income Tax (1954 Code). The specific Regulations permit the deduction of attorneys' fees even though paid in a divorce or separate maintenance proceeding if properly attributable to the production or collection of amounts includible in gross income under Section 22(k) (alimony) of the 1939 Code and Section 71 of the 1954 Code. In *Bingham's Trust v. Commissioner, supra,* it was held that Section 23(a)(2) established two classes of deductions, (1) ordinary and necessary expenses paid or incurred for the production or collection of income and (2) ordinary and necessary expenses paid or incurred for the management, conservation or maintenance of property held for the production of income. As was stated in *Bingham's Trust v. Commissioner,* they are *in pari materia* with the deductions allowed in Section 23(a)(1), viz., trade or business expenses. It is elementary that things equal to the same thing are equal to each other. It therefore follows that the part of an attorney's fee paid in a divorce or separate maintenance proceeding which is properly attributable to the management, conservation or maintenance of property held for the production of income should be just as deductible as when properly attributable to the production or collection of income.[4]

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[4]The point at which *Lewis v. Commissioner* (2 Cir., 1958) 253 F. 2d 821, departs from the majority of the Circuits and the Court of Claims (*Baer v. Commissioner* (8 Cir., 1952) 196 F. 2d 646; *Bowers v. Commissioner*[3] (6 Cir., 1957) 243 F. 2d 904; *Owens v. Commissioner* (5 Cir., 1959) 273 F. 2d 251; *Patrick v. U. S.* (4

WERE THE LEGAL EXPENSES PAID TO DEFEND AGAINST A LIABILITY?

Did Don Gilmore have a liability for the settlement of property? By analogy to *Lykes v. U.S.*, 343 U.S. 118, petitioner asserts erroneously that:

> "The Court of Claims allowed the taxpayer-husband a deduction of 80 percent of the legal expenses he incurred in contesting both the divorce and his liability for the settlement of property." (P.B. 32.)

The court below did not find nor did it hold that there was an issue in the divorce action of any liability of Don Gilmore for the settlement of property. The controversy over community property concerned (1) the extent to which community income was reflected in the increase in value of Don Gilmore's stock and (2) what part, if any, of such increase in value, assuming that it consisted in whole or in part of community, belonged to Dixie Gilmore. Appellee submits that if the court had found in favor of Dixie Gilmore, it would have had to determine how much of the appre-

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Cir., 1961) 288 F. 2d 292, and *McMurtry v. U. S.* (Ct. Cl. 1955) 132 F. Supp. 114) seems to be the weight placed on the origin of the dispute. The court in *Lewis* seems to slant its reasoning toward the view that if the disputed expenses were incurred in a marital dispute, they are not deductible as expenses paid or incurred in the conservation or maintenance of property held for the production of income even though the taxpayer was motivated in paying or incurring such expenses solely because his income-producing property was in jeopardy. The majority view on the other hand seems to be that if the threat against the income-producing property is so great that it endangers the property and the income-producing capacity of the taxpayer, services for the conservation of the property should be regarded as divisible and separate from those rendered in regard to the divorce or legal separation.

ciation in value of the stock was attributable to community income and how Dixie Gilmore was to recover her share. The question was the extent of Dixie Gilmore's rights to or interest in the alleged element of community property and not Don Gilmore's liability to Dixie Gilmore, except insofar as the court might impose some obligation on Don Gilmore to assure the distribution to Dixie Gilmore of the amount of community to which she would be held entitled. The liability would therefore be an obligation to perform a remedy given to assure distribution to Dixie Gilmore. Unlike *Lykes v. U.S.*, supra, the controversy in Gilmore was over alleged specific community property which was attacked directly. In *Lykes*, the controversy concerned the question of indebtedness of a taxpayer for gift taxes; the claimed liability did not concern specific property and no attack was made against specific property held for the production of income.

WHETHER THE LEGAL EXPENSES FOUND TO BE DEDUCTIBLE BY THE COURT BELOW SHOULD IN PART BE HELD TO BE CAPITAL EXPENDITURES IN DEFENSE OF TITLE TO PROPERTY.

Petitioner is completely in error in asserting that part of the expenditures in Gilmore are capital in nature because they were incurred in defense of title to property. There are at least two conclusive answers to this assertion. First, the answer given by the court below (R. 120), viz., that the stocks in question belonged to plaintiff before he was married, after he

was married, and his wife never claimed that he did not hold title to them. (In fact her claim to a community interest in the property depended on his title.) Don Gilmore had clear title to the stock. He could transfer the shares of stock freely.

The statutes and regulations applicable to this question are Section 24 of the 1939 Internal Revenue Code, Section 263 of the 1954 Internal Revenue Code, Treasury Regulations 118, Section 39.24(a)-2, subdivision (a), and Treasury Regulations on Income Tax (1954 Code) Section 1.263(a)-2, subdivision (c).

Section 24 and corresponding Section 263 provide that any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate is a capital expenditure and is not deductible. The applicable regulations under these code sections give as one example, the cost of defending or perfecting title to property. It appears that the statutes and regulations apply only if the cost of defending or perfecting title meets the test of enhancing the value of the property.

Don Gilmore's defense of his stock was not for the purpose of adding anything to its value; the stock was readily transferable and marketable and did not become untransferable or unmarketable because of the claims made by Dixie Gilmore. Nor was any value added to the stock by his successful defense.

Secondly, petitioner's argument that the legal expenses were capital in nature shows a lack of understanding of the community property system. Dixie

Gilmore alleged that the increase in value of the stock was community property because it consisted of earnings resulting from the personal services of Don Gilmore. Under California law community property is property acquired during marriage by the labor or skill of either spouse. *Estate of Arstein* (1961) (Calif.) 56 A.C. 229, 364 P. 2d 33; *Pereira v. Pereira*, 156 Cal. 1, 103 P. 488. Community property is therefore either an accumulation of community income or property purchased or acquired with community income. Therefore, Dixie Gilmore's claim was to unrealized accumulated community income alleged to be included in the increment in value of Don Gilmore's stock. The manner and extent to which Don Gilmore would have to account to Dixie Gilmore for her share of the community income if the court had found that there was community property reflected in the increase in value of the stock was an entirely different matter which the divorce court never reached.

The analysis of petitioner's contention that the legal expenses were capital expenditures also results in the conclusion that Don Gilmore has an alternative ground for deducting the legal expenses in issue. It has been held that legal expenses incurred in any litigation to protect the right of income produced or to prevent others from acquiring a right, title or interest therein is proximately related to the production or collection of income, and such legal expenses are deductible under the "production or collection of income" provision of Section 23(a)(2) of the 1939 Internal Revenue Code. *Falls v. Commissioner* (1946)

7 T.C. 66, following *Estate of Frederick Cecil Bartholomew*, 4 T.C. 349. Therefore insofar as Don Gilmore's legal expenses were incurred in a controversy over accumulated income or gain in value of his stock, they are deductible under Section 23(a)(2). The Treasury Regulations 118, Section 39.23(2)-15, subdivision (b) stated that: "The term 'income' for the purpose of Section 23(a)(2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * * " The corresponding Treasury Regulations on income tax (1954 Code) Section 1.212-1, subdivision (b) is to the same effect.

Nor do petitioner's authorities sustain the contention that under the facts of the case at bar some of the legal expenses in question should be capitalized. *Harris v. U.S.* (9 Cir.) 275 F. 2d 238, concerned a claim by a wife in a divorce suit that she should be a party to the title of real property which stood in the name of her husband. It does not appear whether the wife's claim was to any increment in value of the real property. Under California law, there is a significant distinction between a claim by a wife that she has a community property interest in real property as compared with a claim of community interest in personal property, as in the case at bar. California Civil Code Section 172a provides that the husband cannot convey community real property alone. His wife must join

with him in executing the deed or any instrument by which the community real property is conveyed. In the case of community personal property, on the other hand, the husband's title permits him to transfer without his wife. Therefore, if a wife contests her husband's title in real property by claiming a community interest therein and the husband wins the contest, he succeeds in perfecting title in himself. Thereafter he can convey the property without his wife's signature.

It should be observed that in *Harris v. U.S.*, supra, at p. 240, the Court of Appeals reaffirmed its approval of the rule in *Baer v. Commissioner*, supra, as shown by the following quotation:

> "In Baer v. Commissioner, * * * the showing was of expense to the taxpayer in resisting a claim which threatened immediate destruction, to a substantial extent, of his capacity to earn income. The legal expense incurred was thought to bear a direct relationship to the management and conservation of property held for the production of income. * * * The Baer case, we think, affords a good illustration of the proper application of the statute."

Doubtless the Court of Appeals would not have treated the legal expense as a capital expenditure if the facts had come within the court's illustration of the proper application of the *Baer* rule.

Shipp v. Commissioner of Internal Revenue (9 Cir.) 217 F. 2d 401, is distinguishable from the case at bar. In *Shipp* the legal expenses were incurred in

defense of an action to quiet title to property. The suit was brought by an executor of a deceased wife's estate against the surviving husband praying for a judgment declaring certain assets to be community property and that title to such property should be quieted in the executor. The Tax Court made a finding of fact that the fees were paid in defense of title and were thus capital expenditures. The contest over title in *Shipp* is different from the contest in Gilmore. Dixie Gilmore did not contest Don Gilmore's title to the stock. Even had she succeeded in impressing a community interest on the stock, Don Gilmore would still have held title and the stock would have been freely transferable by him alone, accountable however to Dixie in respect to proceeds of sale. His position would have been that of a constructive trustee for her community interest.

Appellee recognizes that every expenditure to conserve income-producing property has an aspect of a capital expenditure. In the case at bar, any aspect of capital expenditure was purely incidental. The attack made on Don Gilmore's stock consisted of a claim that community income built up the appreciation in value of the stock. The defense by Don Gilmore was against such claim. Any question of title which might ultimately follow, possibly in another law suit, would be incidental. This view is supported by *Rassenfoss v. Commissioner* (7 Cir.) (1946) 158 F. 2d 764, and *Hochschild v. Commissioner* (2 Cir.) 161 F. 2d 817. In *Sergievsky v. McNamara* (1955) 135 Fed. Supp. 233, 238, the court states as follows:

"The mere fact that the plaintiff's Climax shares may have been affected by the Turner action, did not mean that the legal expenditures by plaintiff were directly for the defense of title. Otherwise, every expenditure to conserve income-producing property would be a capital expenditure, thereby emasculating a part of § 23(a)(2). That statute explicitly permits acts to conserve property without necessarily treating such expenses as items of capital cost. Such expenses as were involved in plaintiff's beating off an ill-founded suit did not add to or enhance her property. In deciding such questions, the courts as Judge Learned Hand has said, do not substitute 'juristic metaphysics' and 'theoretic analysis' for more conventional and accepted notions."

CONCLUSION

For the foregoing reasons, the judgment of the court below should be affirmed.

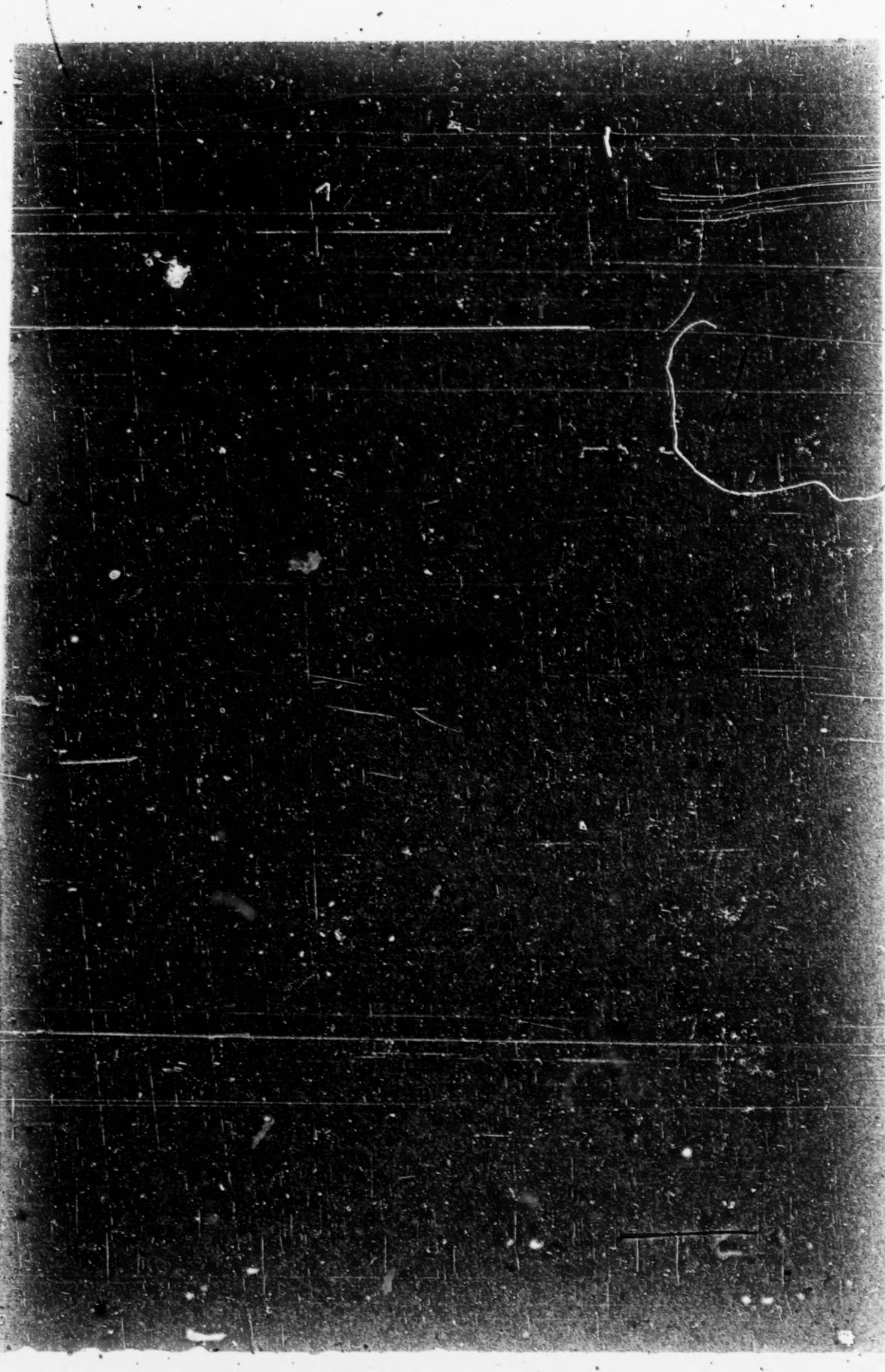
Respectfully submitted,

ELI FREED,

Attorney for Respondent Don Gilmore.

February, 1962.

(Appendix Follows.)



Appendix

Treasury Regulations 118:

§ 39.23 (a)-15 Nontrade or nonbusiness expenses.

(a) Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a) (2) only upon the condition that:

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, * * *; and

(2) It is an ordinary and necessary expense for either or both of the purposes stated in subparagraph (1) of this paragraph.

(b) The term "income" for the purpose of section 23(a) (2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * *

Treasury Regulations on Income Tax (1954 Code)

§1.212-1 Nontrade or nonbusiness expenses.

(a) An expense may be deducted under section 212 only if—

(1) It has been paid or incurred by the taxpayer during the taxable year (i) for the production or col-

lection of income, which, if and when realized, will be required to be included in income for Federal income tax purposes, * * *; and

(2) It is an ordinary and necessary expense for any of the purposes stated in subparagraph (1) of this paragraph.

(b) The term "income" for the purpose of section 212 includes not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * *

Internal Revenue Code of 1939 (26 U.S.C. 1953 ed.):

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in [redacted] be allowed in respect of—

* * *

(2) Any [redacted] paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate, * * *.

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 263. CAPITAL EXPENDITURES.

(a) *General Rule.*—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments

made to increase the value of any property or estate. [Exceptions]

Treasury Regulations. 118:

SEC. 39.24(a)-2 *Capital expenditures*—(a) * * * The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. * * *

Treasury Regulations on Income Tax (1954 Code):

SEC. 1.263(a)-2. *Examples of capital expenditures.*

* * * * *

(c) The cost of defending or perfecting title to property.